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September 12, 1993

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Ms. Donna R. Searcy
Secretary
Office of the Secretary
Federal Communications Commission
Washington, D.C. 20554

Re: MM Docket No. 92-51

Dear Madam Secretary:

Enclosed for inclusion in the record in MM Docket No. 92-51, and for consideration by the Commissioners, are an original reprint and nine copies of an article which appears in the current issue of the UCLA Federal Communications Law Journal entitled Toward a Compromise on Collateralizing Loans to Broadcasters.

Thank you for your attention to this matter.

Very truly yours,

David Isenberg
for SHEPPARD, MULLIN, RICHTER & HAMPTON

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Toward a Compromise on Collateralizing Loans to Broadcasters

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The authors acknowledge the contributions to the body of scholarship in the area of secured broadcast finance made by counsel for the creditors in the *Tak Communications* and *Ridgley Communications* cases, which are discussed extensively in this Essay. Any errors of fact or theory are solely the authors'.

I. INTRODUCTION

In 1968, the Federal Communications Commission enunciated a policy against granting collateral liens in FCC broadcast licenses.[1] This policy is in conflict with established bank lending principles for the communications industry, which look to the commercial value of the license as collateral.[2] However, this policy did not materially impact the availability of broadcast financing from bank lenders until a convergence of events occurred in the late 1980's and early 1990's.

First, broadcasting companies began to decrease in value as a result of the industry-wide decrease in advertising revenues.[3]

Second, at the same time that the value of broadcasting companies began to drop, the banking industry underwent a separate restructuring, as part of the fallout from the savings and loan crisis. As a result, federal banking regulators imposed much more stringent lending criteria upon banks. These criteria have recently been relaxed by the regulators.[4]

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1. *See* Radio KDAN, Inc., Memorandum Opinion and Order, 11 F.C.C.2d 934 (1968) [hereinafter Radio KDAN]. This action concerned an application to transfer a broadcast license without the underlying broadcasting equipment, which had been foreclosed upon. In footnote 1 of its order, the Commission noted that it had previously rejected an application for transfer made by the foreclosing creditor as a violation of rule against reversionary interests. In so noting, the FCC commented that "the extraordinary notion that a station license issued by this Commission is a mortgageable chattel in the ordinary commercial sense is untenable." *Id.* at 934 n.1.

2. In response to the petition for declaratory rulemaking filed on February 21, 1991, by the law firm of Hogan & Hartson, the FCC initiated a rulemaking proceeding proposing that creditors be permitted to take either a limited security interest or a reversionary interest in an FCC broadcast license. Review of the Commission's Regulations and Policies Affecting Investment in the Broadcasting Industry, Notice of Proposed Rule Making and Notice of Inquiry, 7 FCC Rcd. 2654 (1992) [hereinafter Investment in the Broadcast Industry NPRM].

A number of major bank lenders to the broadcasting industry submitted comments noting the conflict. *See* Comments of Bank of America National Trust and Savings Association to the Notice of Proposed Rulemaking in MM Dkt. No. 91-0221A (April 12, 1991); Comments of Security Pacific Corporation in MM DKt. No. 91-0221A (April 15, 1991); Comments of American Security Bank in MM Dkt. No. 91-0221A (April 19, 1991).

3. Bruce E. Rosenblum, *Structuring and Restructuring Secured Loans to Broadcasters* 1 J. BANKR. L. & PRAC. 271, 271 (1992).

4. The FCC has specifically acknowledged the destructive impact of restrictive lending rules on the media industry:

> We note that the Board of Governors of the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation recently altered guidelines and reporting requirements

Third, the combined effects of decreasing revenues, decreasing availability of financing and increased financing costs forced a number of broadcasting companies into the bankruptcy system.[5]

This convergence of events has been so damaging to the value of broadcasting companies and the availability of broadcast financing from bank lenders that on February 21, 1991, a petition was filed with the FCC requesting that the FCC affirm the ability of a lender to take a limited security interest in a license.[6] The FCC requested public comment on the petition and, on March 12, 1992, commenced a rule-making proceeding to determine whether a change in FCC policy concerning the availability of liens on licenses is warranted.[7] This rule-making proceeding is pending.

At the same time that the FCC commenced this rule-making proceeding, a United States bankruptcy court sitting in Baltimore, Maryland, handed down its opinion in a broadcaster bankruptcy case called *In re Ridgely Communications, Inc.*.[8] The *Ridgely* court broke ranks with prior bankruptcy court decisions and ruled that a lender could indeed take a security interest in the limited right of the licensee to receive remuneration from a transfer of the license.[9]

The *Ridgely Communications* case presents an elegant compromise between the legitimate concerns of the FCC embodied in the policy against liens on licenses and the needs of lenders, who are called upon to finance transactions involving the sale of

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concerning highly leveraged transactions, finding that changed circumstances and an unintended and undue effect on the availability of capital justified relaxation of some guidelines. The majority of commenters in the proceeding leading to that action specifically raised concerns about the availability of capital to the media industries.

Investment in the Broadcast Industry NPRM, *supra* note 2, 7 FCC Rcd. at 2654 n.1. In the action referred to by the FCC, the agencies involved did away with the supervisory definition of highly-leveraged transactions (HLTs) and discontinued the requirement that banking organizations report their HLT exposure. *See* Supervisory Definition of Highly-Leveraged Transactions, 57 Fed. Reg. 5,040 (1992).

5. Rosenblum, *supra* note 3, at 271.

6. The petition was filed by the law firm of Hogan & Hartson on February 21, 1991. Investment in the Broadcast Industry NPRM, *supra* note 2, 7 FCC Rcd. at 2657.

7. *Id.* at 2657-59.

8. *In re Ridgely Communications, Inc.*, 139 B.R. 374 (Bankr. D. Md. 1992).

9. *Ridgely,* 139 B.R. at 379.

FCC-licensed broadcasters.[10] However, the *Ridgely Communications* decision poses its own challenges, including the court's bifurcation of the broadcast license into lienable and unlienable portions.[11]

This Essay will review the history of the FCC policy against allowing liens on licenses and the subsequent interpretation of that policy by the bankruptcy courts. This Essay will then analyze the efficacy of the legal theories underlying *Ridgely Communications* to determine whether the result reached by the *Ridgely* court is supportable under applicable state secured transactions law and the policy requirements of the FCC.

II. THE ORIGINS OF THE FCC POLICY

Much of FCC policy and procedure is intended to assure that broadcasters remain subject to the public interest and national interest of the United States.[12] The FCC policy against liens on licenses is a creation of FCC adjudicative action, enunciated in a series of commission decisions concerning applications for transfer of licenses from one party to another.[13] While these

10. As this Essay will discuss in depth, the FCC is concerned primarily with assuring the operational independence of broadcasters and the FCC's own control of the issuance of licenses to those broadcasters. Lenders, on the other hand, are concerned with capturing the economic benefit of a transfer of a license without regard for identity of the transferee. By focusing on the economic rights of the licensee, rather than the licensee's operational rights, the court in *Ridgely* was able to fashion relief which did not interfere with the FCC's policies. *See Ridgely,* 139 B.R. at 376-79.

11. *See Ridgely,* 139 B.R. at 376-79. The *Ridgely* court identified the right to receive remuneration upon an assignment of a license as the only property interest of the licensee/debtor at issue, separating out from the analysis so-called public rights of the licensee concerning broadcast operations. *Id.* at 378-79. The court determined that this economic right is a general intangible in which an effective lien may be taken.

The court cited a number of authorities for the proposition that the right to payment upon transfer is a general intangible. *Id.* at 379. However, the court offered no real support for the proposition that the private economic right can be subjected to a lien independently from the public rights which comprise the balance of a licensee's overall bundle of rights under the license.

12. The FCC and the Federal Communications Act conceptualize the license as a public trust, entrusting the broadcaster to operate a station for the public's benefit at the pleasure of the FCC. *See* 47 U.S.C. §§ 301 (purpose of Communications Act is to maintain the control of United States over channels of radio communication), 307 (licenses are to be granted in accordance with "public convenience, interest, or necessity") (1988).

13. The FCC's decisions in this area include: Twelve Seventy, Inc., Memorandum Opinion and Order, 1 F.C.C.2d 965 (1965); Radio KDAN, *supra* note 1; and Kirk Merkley, Receiver, Memorandum Opinion and Order, 94 F.C.C.2d 829 (1983).

decisions have the same legal effect as regulations,[14] they are necessarily fact specific and, unlike formal regulations, are not subject to public comment and do not purport to weigh all potential concerns of lenders and licensees generally.

The seminal FCC decision is *In re Applications of Kirk Merkley*.[15] Mr. Merkley, a state court receiver, was appointed by a state court judge to enforce a reversionary interest in favor of the seller of a radio station.[16] At the FCC, the purchaser objected to an involuntary transfer of control to Mr. Merkley be-

14. *See* New Bank of New England, N.A. (*In re* Tak Communications, Inc.), 138 B.R. 568 (Bankr. W.D. Wis. 1992), *aff'd*, 1993 U.S. App. LEXIS 2027 (7th Cir. Feb. 9, 1993), in which the district court affirmed that the FCC's administrative adjudications had preemptive effect with respect to conflicting state law, even though no formal rulemaking procedure had been complied with. The bankruptcy court stated that:

> It is clear that a state law permitting the banks to have a security interest in FCC licenses would conflict directly with the FCC's policy against such security interests and would be preempted by federal law. *See Capital Cities Cable Inc. v. Crisp* 467 U.S. 691, 699 (1984) (preemption occurs "when compliance with both state and federal law is impossible"). That the policy was not created through rulemaking procedures does not diminish its force of law. Agencies may establish rules of general application through individual adjudication. *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974). [The court here notes that in NLRB v. Hendricks Co. Rural Elec. Membership Corp., 454 U.S. 170, 188 (1981), the Supreme Court held that another aspect of the *Bell Aerospace* decision should be abandoned.]

Id. at 578 (some footnotes and parallel citations omitted).

The district court's holding was recently affirmed by the Seventh Circuit. The Court of Appeals distinguished *Ridgely Communications* by noting that, among other things, the *Ridgely* decision was concerned only with the right to receive proceeds upon sale, whereas the *Tak Communications* appellants sought to enforce all available remedies under the Uniform Commercial Code, including the power to foreclose on the licensee's interest in the license. The appeals court noted that "[t]he [*Ridgely*] court emphasized that its holding was narrow and did not confer a broad right to assert blanket security interests in broadcasting licenses or to use a secured interest to force the debtor to transfer the license to the creditor or a third party." 1993 U.S. App. LEXIS 2027, at *6. The court found that past FCC policy prevented use of a license as security, and determined to follow this policy, declaring that "[w]hether to permit such interests is, as the [*Tak Communications*] parties agree, a matter for the FCC rather than the courts to decide." *Id.* at *10.

15. Kirk Merkley, Receiver, Memorandum Opinion and Order, 94 F.C.C.2d 829 (1983) [hereinafter Kirk Merkley]. In Kirk Merkley, the FCC enunciated several applicable communications policies, including the following policy: "[t]he Commission has consistently held that a broadcast license, as distinguished from the station's plant of physical assets, is not an owned asset or vested property interest so as to be subject to a mortgage, lien, pledge, attachment, seizure, or similar property right." *Id.* at 830 (citations omitted).

16. *Id.* at 832-34.

cause such reversionary interests are expressly prohibited under the regulations governing telecommunications.[17] The FCC agreed, holding that, because the basis for the receiver's appointment was improper, the receiver's application for change of control must be rejected as improper. In so holding, the FCC noted that it has consistently held that a license, as distinguished from the station's plant or physical assets, is not an owned asset or vested property interest, and thus not subject to a mortgage, lien, pledge, attachment, seizure, or similar property rights.[18] In support, the FCC cited sections 301, 304, 309(h), and 310(d) of Title 47 of the U.S. Code, and section 73.1150 of the FCC's rules.[19]

A. In re Merkley *and the Communications Act*

The statutory authority relied upon by *Merkley* does not support the FCC's total ban against granting liens on licenses or the licensee's rights with respect thereto. This is because the Communications Act is primarily concerned with operational rights, not the licensee's economic rights.[20] Section 301 of the

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17. *Id.* at 835.

18. *Id.* at 838-39. The Commission, referring to its policy prohibiting the use of a broadcast license as security, see supra note 15, held that "to now recognize the Receiver's right to the license through the enforcement of the original [sales] agreement's [license reversion] provision would be tantamount to a recognition of a vested security interest in the license itself. Clearly, this is contrary to established law and policy." *Id.* at 839.

19. *Id.* at 830. 47 U.S.C. §§ 301, 304, 309(h) and 310(d) (1988). These code sections are interpreted in the next section of this essay.

47 C.F.R. § 73.1150(a) (1992) provides that "[i]n transferring a broadcast station, the licensee may retain no right of reversion of the license, [and] no right to reassignment of the license in the future." This section applies to situations where a seller wishes to retain the right to retake the license as security for the payment of its sales price. It does not apply, on its face, to third parties who reserve a security interest in the proceeds from a sale of the station's assets and license.

20. See Bill Welch, Memorandum Opinion and Order on Review, 3 FCC Rcd. 6502 (1988) [hereinafter Bill Welch], in which the FCC noted that:

> Our analysis begins with the language of the statute. At the outset, the plain language of Sections 301 and 304 of the Act does not address the sale of authorizations for stations, whether built or unbuilt, for-profit or not for-profit. Rather, the language of these sections . . . seems to address congressional concerns that the Federal Government retain ultimate control over radio frequencies, as against any rights, especially property rights, that might be asserted by licensees who are permitted to use the frequencies. The language does not bar the for-profit sale to a private party, subject to prior Commission approval, of whatever private rights a permittee has in its license.

Id. at 6503 (footnotes omitted).

Code provides for the limited use of radio transmission channels under a license granted by federal authority. Section 301 also recognizes limited rights, declaring that "no such license shall be construed to create any right, beyond the terms, conditions, and periods of the license."[21] Section 301 does not explicitly or implicitly indicate that the granting of a lien on the limited economic rights of a licensee in the license would be inconsistent with communications policy.

Section 304 is also cited in *Merkley*. Section 301 requires that licensees waive any future claim against the United States to use any particular frequency as a result of the licensee's prior use thereof under a license.[22] Section 304 does not in and of itself constitute a practical or theoretical barrier to the granting of security interests in the licensee's economic rights in its license.[23]

The third section referred to in *Merkley*, section 309(h), provides that certain language must be set forth on the face of a license.[24] This mandated language includes a statement that the license shall not be assigned or transferred in violation of the Act. Section 309(h) is not inconsistent with the granting of a

21. 47 U.S.C. § 301 (1988) states in pertinent part:

> It is the purpose of this chapter, among other things, to maintain the control of the United States over all channels of radio transmission; and to provide for the use of such channels, but not the ownership thereof, by persons for limited periods of time, under licenses granted by Federal authority, and no such license shall be construed to create any right, beyond the terms, conditions, and periods of the license.

Section 301 recognizes that licensees do have rights, and that it is only the *scope* of those rights that is limited by terms of the Communications Act.

22. 47 U.S.C. § 304 (1988).

23. Section 304 is intended to preclude any claim of actual ownership of a broadcast spectrum based on adverse possession or related theories by broadcasters, and is consistent with the policy against ownership set forth in section 301. Although this section requires licensees to disclaim a superior use right, it does not in any manner prevent the creation of limited duration rights associated with the licensee's temporal interests in a license.

24. 47 U.S.C. § 309(h) (1988) states in pertinent part:

> [E]ach license shall contain, in addition to other provisions, a statement of the following conditions to which the license shall be subject: (1) The station license shall not vest in the licensee any right to operate the station nor any right in the use of the frequencies designated in the license beyond the term thereof nor in any other manner than authorized therein; (2) neither the license nor the right granted thereunder shall be assigned or otherwise transferred in violation of this chapter.

A third condition subjects the licensee to the war powers of the President that arise under 47 U.S.C. § 606 (1988).

limited lien on the broadcast license.[25] A lien on the proceeds and profits of a license, which does not interfere with the FCC's exclusive control over the identity of licensees, does not offend the policy, purpose or letter of the Act.

Finally, the FCC in *Merkley* also referred to section 310(d). Section 310(d) provides that:

> No license or any rights thereunder shall be transfered, assigned or disposed of in any manner, voluntarily or involuntarily, directly or by transfer or control of any corporation holding such a permit or license, to any person except upon application to the Commission and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby.[26]

By its plain language, section 310(d) prohibits not just transfers of the entire license, but also transfers of any rights *thereunder*. This restriction could be erroneously read to bar liens on both operational and economic attributes of the license. The restriction *should* instead be read in light of the FCC and congressionally recognized distinction between the broadcaster's private economic rights *in* the license and the public operational rights of the broadcaster *under* the license. Properly interpreted, section 310(d), which refers exclusively to rights "thereunder," restricts transfer only of the entire license or the operational rights of a licensee *under* a license. Had Congress intended to restrict the transfer of a licensee's economic rights *in* a license, it could have done so.[27]

B. FCC Recognition of the Public-Private Distinction

In response to a recent application filed with the commission by Bill Welch, the FCC approved the for-profit transfer of a cellular telephone construction permit.[28] In approving the trans-

25. The "right granted thereunder", referred to in section 309(h), is the licensee's right to broadcast over a specific frequency pursuant to the license. The distinction between operational rights "under" a license and economic rights "in" a license lies at the heart of the proposal set forth in this Essay. This distinction was recognized by the FCC in *Bill Welch, supra* note 20, at 6503-04.

26. 47 U.S.C. § 310(d) (1988).

27. The FCC in *Bill Welch, supra* note 20, indicated its understanding of the position of Congress with regard to interests in licenses. The intent was to limit "a licensee's long-term rights vis-a-vis the Federal Government; nothing was said about restricting a licensee's ability to earn a profit on the value inherent in its authorization." *Bill Welch, 3 FCC Rcd. at 6503. See id.* at 6506-06 nn.29 & 30.

28. *Id.* at 6502.

fer of the construction permit, the FCC noted that sections 301 and 304 of the Act seem to address concerns that the government retain ultimate control over radio frequencies, superior to any rights, especially property rights, that may be asserted by licensees.[29] The FCC further noted that the statutory language "does *not* bar the for-profit sale to a private party, subject to prior Commission approval, of *whatever private rights a permittee has in its license*."[30] The FCC further noted that the statutory ownership restrictions relate to the licensee's rights vis-à-vis the federal government, not its right in the license to make a profit from an approved transfer of the license.[31]

Thus, the FCC recognizes a distinction between a broadcaster's right to operate granted under a license, which is a public right, and a broadcaster's right to assign a license for profit to an approved buyer, which is a private right. As the FCC noted in *Bill Welch*, such private rights are beyond the reach of the existing statutory prohibitions against transfer.[32]

This result is actually quite straightforward. The Act and FCC policy are concerned with control of the airwaves. Thus, FCC approval of a transfer of a license or any operational rights under a license is required. By contrast, the FCC recognizes that Congress intended to permit licensees to control their ancillary economic interests in the license free from FCC restriction. The FCC is concerned with the qualifications and independence of its licensees, not their economic affairs.

Because the right to receive profit upon the transfer of a license is a private right, beyond the control of the FCC, the disposition of that profit by the licensee certainly must be a private right beyond the scope of the statutory scheme.

Assignment by a licensee of its right to receive remuneration from a transfer of a license does not in any way impinge upon the operational independence of the licensee during the period prior to a sale nor does it interfere with the FCC's interest

29. *Id.* at 6503.

30. *Id.* (emphasis added and footnotes omitted)

31. *Id.*

32. In *Bill Welch*, the FCC noted in pertinent part as follows: "the ownership restrictions related to a licensee's rights vis-a-vis the Federal Government, not its rights to make a profit from its authorization upon a transfer or assignment approved by the Commission." *Id.* at 6503.

in being the final arbiter of the acceptability of proposed new licensees. Thus, under the logic employed by the FCC in *Bill Welch*, the private right to receive remuneration should not be one of the rights requiring FCC approval for transfer under section 310(d).

III. FCC POLICY IN BANKRUPTCY COURT

The FCC's policy against liens on licenses, as enunciated in *Merkley*, has been litigated in bankruptcy court in recent years. We will now turn to the impact of this policy upon the bankruptcy process and upon the expectations of broadcast lenders.

The earliest reported bankruptcy court case dealing with the FCC's policy against liens on licenses appears to be a Sixth Circuit Court of Appeal case entitled *Stephens Industries, Inc. v. McClung*.[33] This case, decided in 1986, concerns an appeal by the seller of a radio station who held a purchase money note secured by a mortgage on all assets of the radio station.[34] The issue before the court was whether the secured creditor was entitled to credit bid its debt at a public sale. The court, in holding that the creditor did not have an effective lien, ruled that it was not entitled to make a "set-off" bid, and was permitted only to bid cash.[35] The court approved a sale of the station by the Chapter 11 trustee free and clear of any lien in either the license or the proceeds and profits thereof.[36] In coming to this conclusion, the Court of Appeals relied exclusively on the holdings of the FCC in *Merkley* and *Radio KDAN, Inc.*, as well as 47 C.F.R. § 73.1150(a), which unambiguously bars those selling a station from retaining a reversionary right therein.[37] *Stephens Industries* stands only for the proposition that a seller cannot avoid the ban on the reversionary interests by structuring the transaction as a secured note instead of an installment sale. *Stephens Industries* does not address true third party financing and does not establish any rules with respect to third party liens.[38]

33. 789 F.2d 386 (6th Cir. 1986).
34. *Id.* at 387.
35. *Id.* at 390-91.
36. *Id.* at 390. *See* discussion of section 73.1150(a) in note 19, supra.
37. *Id.* at 390.
38. *Stephens Industries* is similar to a number of cases handed down by bankruptcy courts which address this question. These cases all continue the flawed analysis which originated at the FCC, in which broad anti-lien language is used to explain

The FCC policy against liens on licenses next arose in the case of *In re Smith*.[39] In *Smith*, a Chapter 7 trustee sought leave of court to assign a license. A creditor objected, asserting a perfected first priority lien on the license and seeking abandonment of the license by the estate to the creditor. The trustee replied to the creditor's objection on the ground that, regardless what the security documents may say, no effective lien may be granted in a license pursuant to FCC policy, citing *Merkley* and *Stephens Industries*.[40] The bankruptcy court agreed, holding that the creditor did not have a security interest in the license at issue in that case, regardless of the terms of the documentation.[41] Unfortunately, the court did not specify whether the lien in question applied solely to private economic rights, or whether the lien also purported to include operational rights under the license, which would clearly violate existing FCC policy.[42]

In the case of *New Bank of New England, N.A. (In re Tak Communications, Inc.)*, the broadcaster's secured bank lenders sought to enforce a security interest in a FCC license.[43] *Tak*, for the first time, made the validity of a documented, perfected, security interest on a broadcast license the main question for decision.[44] Affirming the holding of the bankruptcy court below on

rulings which invalidate reversionary interests. The broad dicta is not persuasive because it is extended from cases which are clearly subject to 47 C.F.R. § 73.1150(a) (1992) (prohibition on the retention of reversionary interest in seller of broadcast license) to cases which are not controlled by any existing federal regulation. *Stephens Industries* is not controlling or relevant to the discussion herein, except to the extent that it has been *misapplied* by subsequent courts.

39. 94 B.R. 220 (Bankr. M.D. Ga. 1988).

40. *Id.* at 221-22.

41. In *Smith*, the bankruptcy court, favoring the interests of the estate over a single creditor, considered the dicta of *Merkley* and *Stephens Industries* and the fact that the creditor could not point to a reported decision involving an FCC broadcast license in its favor. Using this "balancing", the Court elected to follow its interpretation of *Stephens Industries* and *Merkley* and held that the creditor did not have a sufficiently effective lien in the license to permit the creditor to oppose an assignment of the license or to cause the license to be abandoned to it. *Id.* at 221-22.

42. The question of abandonment is beyond the scope of this paper. However, a secured creditor should have a right to object to a sale in bankruptcy court as to price, and should be able to collect the proceeds of such sale. *Smith* does not appear to have addressed the issue of an objection as to price or the right to proceeds, and should not be read to have any precedential value with respect to those issues.

43. New Bank of New England, N.A. (*In re* Tak Communications, Inc.) 138 B.R. 568, 570-571 (Bankr. W.D. Wis. 1992), *aff'd*, 1993 U.S. App. LEXIS 2027 (7th Cir. Feb. 9, 1993).

44. *Id.* at 571. For the first time, the creditors in question were nationally active

appeal, the United States District Court relied on *Merkley* and *Radio KDAN, Inc.*, as well as *Stephens Industries* and *Smith* to determine, as a matter of federal law, that the FCC policy enunciated in *Merkley* and *Radio KDAN, Inc.* preempted state law to the extent that state law permitted such a lien.[45]

The case of *In re Oklahoma City Broadcasting Co.*[46] illus-

financial institutions who had extended a $175,000,000 line of credit to a large broadcasting company. The banks commenced an adversary proceeding for declaratory relief seeking to establish that the banks had a perfected lien in Tak's operating rights *under* the FCC license *and* in Tak's economic right to sell the stations as going concerns. Tak moved for summary judgment for a declaration that the liens were prohibited by law, pursuant to FCC policy. The bankruptcy court agreed with Tak and entered summary judgment against the banks. *Id.*

45. *Id.* at 572-73, 577-78. In *Tak*, the creditors again suffered from the "piling on" effect of the loose dicta which originated in the FCC's reversionary interest cases. In support of its position, the *Tak* court cites only to *Stephens Industries, Inc.* v. *McClung*, 789 F.2d 386 (6th Cir. 1986), *Smith*, and *Continental Bank v. Everett*, 760 F. Supp. 713 (N.D. Ill. 1991), *aff'd* 964 F.2d 701 (7th Cir. 1992). *Continental* concerns an action to avoid liability under a guarantee based on failure to disclose FCC policy, and is irrelevant, aside from a reference in dicta to *Stephens Industries*.

In support of their position, the *Tak* banks cite the original order in *Ridgely Communications*. They argue that the court below had incorrectly applied *Stephens Industries and* that *Stephens Industries* incorrectly relied on dicta in the FCC's cases, as the authors argue in this Essay. The *Tak* court perpetuated the error of the *Stephens Industries* court by failing to realize that the FCC cases concerned clearly prohibited reversionary interests (47 C.F.R. § 1150(a)), and therefore *did not address liens in favor of third party creditors.*

Although the FCC has spoken in broad language that might seem to preclude any security interest associated with a license, there is reason to question the scope of this policy with regard to the question at issue in *Tak*. In *Omega Cellular* Partners, Memorandum Opinion and Order, 5 FCC Rcd. 7624 (1990), the FCC stated that:

> It is well established that a license is not an asset of the licensee and does not give any property rights in the license itself, that the Commission does not recognize a security interest in a license, and that credit cannot be extended in reliance upon the license as an asset from which a licensee's obligations may be satisfied.

Id. at 7624. While the Commission's statement indicates that a full blown lien in the operational rights under a license is prohibited, the Commission has never addressed the limited lien at issue in *Tak*.

Further, the Commission's statement in Omega Partners was dicta. The Commission had before it an application by Omega for a cellular service operating license. This application was challenged on the grounds that Omega was financially unqualified and that it had granted a security interest in violation of FCC policy. After setting out the position quoted above, the Commission noted that because the secured creditor claimed such an interest only to the extent that it was permitted by FCC policy, and since the creditor acknowledged that the lien was effective only to the extent permitted, the FCC resolved that question in favor of Omega without further investigation into the policy. *Id.*

46. 112 B.R. 425 (Bankr. W.D. Okla. 1990).

trates the danger of the FCC's policy against liens on licenses to the secured lender's collateral position which underlies the strong reaction of the finance industry to the pending FCC rulemaking procedure. The issue before the *Oklahoma City* court was the valuation of the secured creditor's lien for purposes of distribution of proceeds of sale of the debtor's radio station.[47] The secured creditor apparently did not claim to have an express lien on the license.[48] However, the secured creditor did have a lien on *all* of the *other* tangible and intangible personal property of the debtor and claimed a lien on the financial value of the license.[49] The bankruptcy court held that, in the sale context, the secured creditor was entitled only to the liquidation value of all of the debtor's tangible and intangible assets. The court excluded from this sum the debtor's going concern value, on the grounds that the creditor did not have a security interest in the license itself, and as the court noted "a television station without a broadcasting license is not a going concern."[50]

The court also refused to consider the price offered for the station by a competitor, which the court determined included a *bounty* equal to the competitive value of licensee's operation, and which was beyond the scope of the creditor's lien on general intangibles.[51] The court used the bounty analogy because the purchaser intended to buy the station for the purpose of shutting it down in favor of its own signal, rather than operating it as a separate licensee.[52] This "shut down" aspect of the case constitutes a unique fact situation, and is often overlooked by commentators and litigants.[53] Therefore, *Oklahoma City* has mistakenly taken on a greater meaning, standing popularly for the notion that a secured broadcasting lender is entitled only to the liquidation value of its collateral on a piece by piece basis

47. *Id.* at 427, 428.

48. The court excluded the license from that portion of the debtor's assets in which the creditor claimed a perfected security interest. *Id.* at 428. This fact renders *Oklahoma City* irrelevant to the existing debate, except to the extent of the business impact of its holding.

49. *Id.* at 427-28.

50. *Id.* at 429.

51. *Id.*

52. *Id.* at 430.

53. Presumably, the *Oklahoma City* court would have engaged in a different analysis had the benchmark purchaser intended to operate the station as a going concern, rather than turn it off.

and that, upon a sale of a broadcaster in bankruptcy, the secured creditor will not have any lien on proceeds which are attributable to license.

IV. *RIDGELY* TO THE RESCUE

A secured creditor's apparent inability to capture the monetary value of a license created a significant opportunity for mischief at the expense of the creditor. Without a license, the tangible and intangible assets of a station are just so much equipment with no material value in relation to the fair market value of the station as a going concern. Broadcasters are able to effectively threaten their lenders with the prospect of having to judicially enforce their liens, either inside or outside of bankruptcy, unless the lender cooperates with a broadcaster seeking to restructure its debt.

A. Ridgely *Permits Limited Liens of Licenses*

The inequity of the FCC's policy, as applied, was recognized by the bankruptcy court in the case of *In re Ridgely Communications, Inc.*[54] In *Ridgely Communications*, the bankruptcy court had before it a situation where the insiders of a corporate debtor and its secured creditor were the major parties competing for the proceeds from the post-petition sale of a radio station as a going concern.[55] Therefore, enforcement of a restrictive ban on security interests would allow the insiders to assert their own claims against the proceeds in direct competition with the bank's claims, even though the bank had provided acquisition financing for the radio station at the time of the insider's initial acquisition.[56]

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54. 139 B.R. 374, 380 (Bankr. D. Md. 1992).

55. *Id.* at 375, 380. The pleadings in *Ridgely* set out the factual background establishing that the debtor's former president and owner was the other major creditor, unfortunately, neither the opinion of the Court nor the pleadings describe the basis for the claim. *See* Response and Partial Objection to Motion to Distribute Proceeds and Dismiss Case, filed by the debtor on May 13, 1991 and docketed by the court as item 195; and Ameritrust's Memorandum in Response to Motion to Value Collateral Pursuant to Bankruptcy Code Section 506(a), filed by Ameritrust Company, National Association on June 13, 1991 and docketed by the court as item 202.

56. Had the limited lien on the license been disallowed by the court, the debtor and Ameritrust would have faced the issue of valuation and allocation. The extent that proceeds would ultimately have been attributed to the license, Ameritrust would

The underlying facts and procedural posture of the *Ridgely Communications* case are important, and deserve thorough discussion. On December 10, 1986, Ameritrust Company National Association loaned Ridgely Communications $3,500,000.[57] This loan was perfected by a first priority lien and security interest in all of the personal property owned by Ridgely Communications, including its "licenses (to the extent not prohibited by law)," and certain of its real property.[58] Ridgely Communications used the proceeds of the loan to purchase its principle assets, consisting of two radio stations.[59]

Two and a half years later, Ridgely Communications filed a voluntary petition under Chapter 11 of the Bankruptcy Code.[60] During the pendency of the bankruptcy proceeding, Ridgely Communications sold all of its assets free and clear of liens for $2,500,000. Ameritrust claimed that its lien attached to the sale proceeds. Ridgely Communications sought to value the lien of Ameritrust at $750,000, asserting that Ameritrust was only entitled to the liquidation value of specific items of collateral and did not have a lien on sale proceeds *per se*.[61] The balance of sale proceeds not paid to Ameritrust on account of its secured claim would be distributed to the unsecured creditors.[62] The unsecured creditors included insiders of Ridgely Communications.[63]

Ameritrust objected to the debtor's motion, asserting that Ameritrust had a perfected security interest in all of the property of Ridgely Communications, including the license, and was entitled to all of the net proceeds of the sale of the radio stations.[64]

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have shared in the proceeds attributable to license under its unsecured claim pari passu with the insider's claim to the extent of its pro rata share of such proceeds.

57. *See* Ameritrust's Memorandum in Response to Motion to Value Collateral Pursuant to Bankruptcy Code § 506(a) at 2, *Ridgeley Communications* (Bankr. D. Md. No. 89-5-1705-JS) [hereinafter Ameritrust's 506(a) Response].

58. *Id.* at 2-3.

59. Motion to Value Collateral Pursuant to Bankruptcy Code § 506(a) and to Use Liquidation Valuation, filed by Ridgely Communications, at 1, *Ridgely Communications* (Bankr. D. Md. No. 89-5-1705-JS).

60. *In re* Ridgely Communications, Inc. 139 B.R. 374, 375 (Bankr. D. Md. 1992).

61. *Id.* at 375-76.

62. Response and Partial Objection to Motion to Distribute Proceeds and Dismiss Case, filed by Ridgely Communications, at 4, *Ridgely Communications* (Bankr. D. Md. No. 89-5-1705-JS).

63. *Id.* at 1; Ameritrust's 506(a) Response, *supra* note 57, at 5 n.2.

64. *Id.* at 6-7, 30.

Ameritrust acknowledged that its security interest in the license would not permit Ameritrust to foreclose upon and sell the license, or otherwise exert management or control over the radio station, without prior FCC consent.[65] However, Ameritrust insisted that its security interest did extend to Ridgely Communications' private rights in the license, including the right to receive the seller's remuneration upon an assignment of the license to a new buyer of the radio station.[66]

The bankruptcy court agreed with Ameritrust. The bankruptcy court first held that Ridgely Communications' rights under the licenses were "property of the bankruptcy estate" within the meaning of the bankruptcy code, thus giving the bankruptcy court jurisdiction to adjudicate the interests of parties with respect to those rights.[67] Next, the bankruptcy court found that, while the public policy in favor of government control of the airways indeed forbids the granting of a standard U.C.C security interest in a license, the Act recognizes and permits enjoyment of private rights arising in connection with licenses[68] and such private rights can indeed be subject to a security interest.[69] The bankruptcy court reasoned that no federal interest is vindicated by the policy against liens on a licensee's private right to receive remuneration, criticizing the decision in *Tak* as unpersuasive dicta.[70]

B. Ridgely*'s Bifurcation Theory Is Viable Under the Uniform Commercial Code*

The *Ridgely Communications* case presents a model for addressing the legitimate interests of both the FCC and secured creditors. However, the decision in *Ridgely Communications* presents special challenges because its impact is dependent upon

65. *Id.* at 18.
66. *Id.* at 7-18.
67. *In re* Ridgely Communications, Inc., 139 B.R. 374, 378 (Bankr. D. Md. 1992).
68. *Id.* at 378.
69. *Id.* at 379.
70. *Id.* at 379-80. The *Ridgely* court argued the *Tak* court went too far, and did not need to deprive the secured creditors of the most important collateral of the debtors in order to protect the FCC's legitimate concerns in regulating the use of the airwaves. The *Ridgely* court was particularly distressed that corporate insiders made off with the value of the license under the guise of protecting the FCC's interests. *Id.* at 380.

the efficacy of the bankruptcy court's assumptions concerning a secured creditor's ability to take an effective lien and security interest only in the borrower's private rights in the license, including the right to receive remuneration upon an assignment of the license by the borrower, but excluding from the lien the forbidden operational rights. Therefore, the state and federal law underpinnings of the secured creditor's ability to bifurcate the interests under a license will be examined below.

The effective distinction between non-lienable public rights and lienable private rights in connection with a governmental license appears to be relatively well established.[71] For instance, cases have been decided which support the ability of a secured lender to take a lien on a liquor license or certain of its attributes.[72] A number of courts have held that, even though a liquor license cannot itself be foreclosed upon and sold, an effective security interest *can* attach to the private economic rights possessed by the holder of a liquor license, including the right to receive the cash proceeds of a properly authorized transfer.[73]

In the case of *Harriet's Speakeasy and Landmark Restaurant v. North Shore Deposit Bank (In re Kluchman)*,[74] the Bankruptcy Court addressed the debtor's motion to value the lender's secured claim by excluding any value attributable to a liquor license.[75] The *Kluchman* court found that the secured party had no enforceable security interest in the core right under the license to sell liquor.[76] Therefore, the court noted, in dicta, relief from stay to exercise any claimed security interest in that core right would be inappropriate. However, the *Kluchman* court

71. *Id.* at 379. The *Ridgely* Court relies primarily on *Freightliner Market Development Corp. v. Silver Wheel Freightlines, Inc.*, 823 F.2d 362 (9th Cir. 1987).

72. *See* Harriet's Speakeasy and Landmark Restaurant v. North Side Deposit Bank (*In re* Kluchman), 59 B.R. 13 (Bankr. W.D. Pa. 1985); *In re* Bennett Enterprises, Inc., 58 B.R. 918, 919-20 (Bankr. D. Ma. 1986); Hidden Valley Golf Course, Inc. v. Tittabawassee Investment Co. (*In re* Tittabawassee Investment Co.), 831 F.2d 104 (6th Cir. 1987); O'Neill v. Dorothy (*In re* O'Neill's Shannon Village), 750 F.2d 679 (8th Cir. 1984).

73. *See Kluchman*, 59 B.R. at 15; Fisher v. Cushman (*In re* Fisher), 103 F. 860, 864-67 (1st Cir. 1900).

74. 59 B.R. 13 (Bankr. W.D. Pa. 1985).

75. *Id.* at 14.

76. The bankruptcy court followed the lead of the Pennsylvania Supreme Court in 1412 Spruce v. Comm. Penn. Liquor Control Bd., 474 A.2d 280 (1984), where the Court found that a liquor license was not "property" of the debtor, relying upon PA. STAT. ANN. tit. 47, § 4-468(b.1) (Supp. 1992). *1412 Spruce*, 474 A.2d at 283.

held that an effective security interest *could* be taken in the related rights derived from the liquor license, giving the secured creditor a valid security interest in the proceeds of assignment of a liquor license even though no security interest in the core right to sell liquor was available.[77]

The Ninth Circuit Court of Appeals has taken a similar position with respect to operating authorities issued to a trucking company in *Frieghtliner Market Development v. Silver Wheel Freightlines, Inc.*[78] In that case, the court of appeals considered the question of whether an effective lien could be claimed in the proceeds of the sale of a debtor's transportation operating authorities. The court found that such a limited lien *was* available, even while recognizing that no enforceable lien in the actual right to operate a trucking company under the transportation operating authorities was available.[79] Thus, the *Freightliner* court held that the secured creditor was entitled to the proceeds derived from a sale of the operating authorities even if the secured creditor is not entitled to directly foreclose upon the operating authorities.[80]

The concept of bifurcation between the "public" privilege of conducting the core licensed activity, in which no lien is available, and the "private" right to receive proceeds upon an authorized transfer of that privilege to a new licensee, upon which an effective security interest is available, is well established as a matter of state U.C.C. law and should not present a bar to the vitality of the holding in *Ridgely Communications.*

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77. *Kluchman,* 59 B.R. at 16.

78. 823 F.2d 362 (9th Cir. 1987).

79. *Id.* at 369. The *Freightliner* court distinguished a case in which a public utilities commission was permitted to reduce the scope of the license granted in favor of a transferor upon its assignment to a transferee, Borich Transfer Co. v. Haley, 469 P.2d 638 (Or. Ct. App. 1970). The *Freightliner* court noted that:

> In *Borich*, the private party was attempting to assert a property right against the government. Courts finding that licenses and other governmentally granted privileges constitute property for purposes of the general intangibles provision consistently differentiate the *Borich* situation from that of a purely private credit transaction. These courts reason that, although a license is a privilege vis-à-vis the public authority, it has qualities of a property right as to third parties. Therefore, the operating authorities are general intangibles covered by Freightliner's security agreement.

Frieghtliner, 823 F.2d at 369 (citations omitted).

80. *Freightliner,* 823 F.2d at 369-70.

C. Ridgely's *Bifurcation Theory Is Viable Under Federal Law*

The final issue concerns the availability of bifurcation of interests under a license as a matter of federal communications law. It appears that the best reading of the FCC adjudications permits a limited lien on the licensee's ancillary economic rights in a license.[81] However, the resolution of this issue under existing FCC authority is, at best, ambiguous. This ambiguity is due, in large measure, to the fact that the FCC has elected to address the question of security interests through a series of fact specific administrative adjudications, rather than through the more orderly and disciplined regulatory rule-making process.

A license, like the liquor license or a transportation operating authority, confers upon the licensee the privilege of conducting a certain type of operation. FCC adjudications such as *Omega Cellular Partners*[82] and *Kirk Merkley*[83] evidence a FCC policy that a license cannot be subject to a mortgage, lien, pledge or similar encumbrance. However, in each of these adjudica-

81. In a nutshell, the best reading of existing FCC authority establishes that the FCC has never ruled squarely on the issue of a limited lien on proceeds of general intangibles. The FCC has held, however, in Bill Welch, *supra* note 20, that licensees have property rights in licenses in the context of a purely private transaction. In the absence of a direct prohibition of such liens, the validity of such liens should be assumed. If there is no federal preemption of state law on this question there is no reason to believe that operating licenses should be treated any differently than any other article of collateral. *See generally* Radio Station WOW, Inc. v. Johnson, 326 U.S. 120, 129 (1945) (Supreme Court recognized authority of state court to address issues not within the exclusive jurisdiction of the FCC).

82. In Omega Cellular Partners, Memorandum Opinion and Order, 5 FCC Rcd. 7624 (1990), the FCC indicated that a lien on a cellular license was impermissible because the law does not allow a property interest in a radio spectrum. The FCC stated that:

> It appears that [the creditor] understands that it has no property or security in Omega's future license, and that any security provision in its favor in Omega's license would be unenforceable. The law at the present time allows no property interest in radio spectrum. Accordingly, [the creditor's] conditional security interest in Omega's license is not permitted by law.

Id. at 7624 (citations omitted). In Omega, the FCC assumed that the security interest was intended by the parties to permit a lien to be taken directly on the debtor's property interest in the radio waves. The Court reasoned that because the debtor has no property interest in the radio waves themselves, the lien could not be valid in any manner. This analysis completely ignores the FCC's prior analysis in Bill Welch, which acknowledged the existence and validity of private economic rights in a license as between two private parties. Omega is not well decided and its influence should be discounted.

83. *Kirk Merkley*, *supra* note 15.

tions, the issue before the FCC was an attempt to enforce a lien on the licensee's core operational right to broadcast under the license. None of the cases adjudicated by the FCC actually considered the question of a lien on the limited private right to receive remuneration upon an approved assignment of the license.

In *Bill Welch*, the FCC permitted the owner of a construction permit for a cellular telephone facility to transfer it to another acceptable licensee for profit.[84] In arriving at this decision, the FCC noted the distinction between rights *under* a license, that is the core operating rights conferred by the license, and rights *in* a license, that is the ancillary economic benefits of a license to the licensee.[85]

The FCC characterized these ancillary economic rights in the construction permit as private rights which the holder of the construction permit could transfer.[86] The *Bill Welch* decision establishes that the FCC recognizes a bifurcation between public rights and private rights with respect to a license. Because the FCC recognizes a bifurcation between public rights and private rights, the better interpretation of the scope of the FCC's policy against liens on licenses limits the effect of that policy to liens on the operational public rights under a license. Therefore, a state law security interest in a licensee's private right to receive remuneration upon an assignment of a license should be valid and enforceable under current FCC policy.

V. CONCLUSION

By enforcing a lien on the proceeds of an assignment of a license, *Ridgely Communications* merely extended to broadcasting a well established practice of recognizing limited liens on the private right attributes of certain governmental operating licenses and authorities, even where the core operating rights themselves are not subject to an enforceable security interest.[87] Indeed, the recognition of liens on private rights by *Ridgely Communications* is consistent with existing FCC policy, which should be interpreted to only bars liens on the operational rights under a license. However, because the FCC policy against liens

84. *Bill Welch, supra* note 20.
85. *See, supra,* section II(B).
86. *See, supra,* text accompany note 33.
87. *See, supra,* section IV(B).

was created through the adjudicative process rather than a rule-making process, the intended scope of the policy is ambiguous. Therefore, the FCC should clarify and limit the scope of the prohibition set forth in *Kirk Merkley*[88] and its progeny so as to remove this ambiguity by permitting licensees to grant liens on their private economic rights in a license, including the right to receive the proceeds of an assignment of a license.

88. *See, supra,* text accompanying note 15 *et seq.*